Panel 2: Motivations for Mergers and Key Success and Failure Factors

(Slides & Presentations)

Mergers: A Prescriptive Perspective

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Outline

- Why do managers' assessments of overall success of mergers and their financial success differ?
- What do managers mean by merger success?
- How, strategically, should one think about success/failure?
- What are bases of value creation (not just cost reduction, market power)

Measures of Success

- Stock Price Performance
- Accounting Measures of Profitability
- Others
  - Exploiting overvalued stock (“strong currency”)
  - Maintaining/improving market share rank
  - Implementing strategy
  - Achieving a strategic transformation

A Strategic Scorecard

+ FORESTALLING RISKS
+ GENERATING KNOWLEDGE/ INNOVATION

CEMEX: Value-Addition through Cross-Border Mergers

LEVERS	CEMEX
Accelerating Growth	• Overtook Votorantim as major player
Boosting Margins -Cost Advantage	• Absolute reductions in operating costs through PMI • Scale economies (IT, etc.) • Capital cost reduction through bottomfishing
-Differentiation/ Willingness-to-Pay	• Diversion of imports away from key markets (acquis. of terrminals/most extensive intl. trading network) • Brand-building for the self-construction segment
-Enhancing Industry Attractiveness	• Deliberate emphasis on market restructuring • The benefits of multimarket contact
Forestalling Risks	• Reduced risk of competitive attack • Reduced sensitivity to Mexico risk
Generating Knowledge/ Innovation	• Learning from Valenciana acquisition in Spain (IT)

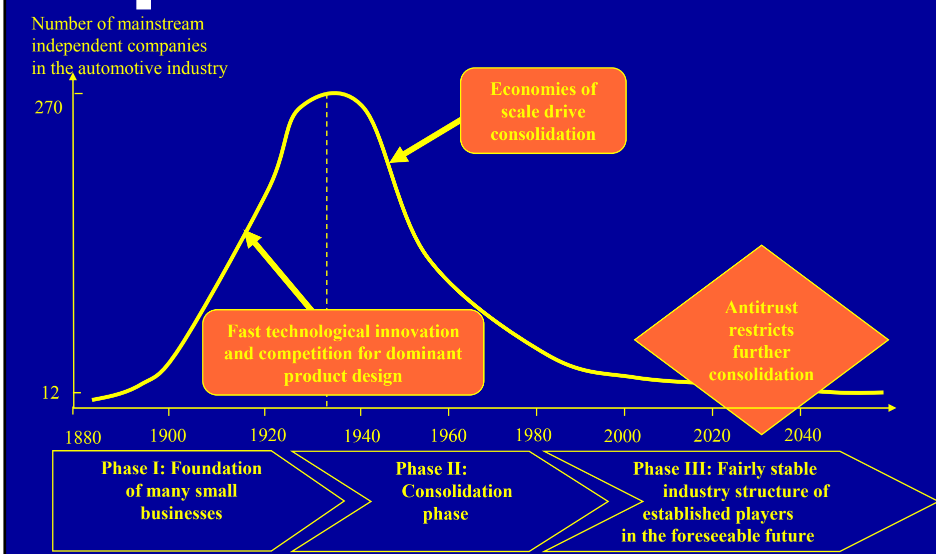
Limits to Value Addition through Merger

Levers Of Value Addition	Limitations
Accelerating Growth	◆Usually not achieved ◆Often a margin-volume positioning tradeoff
Cost efficiencies	◆Cost savings often exaggerated ("the rubber baseline") ◆Costs of takeover premia often left out of the analysis ◆Diseconomies of scale/scope/complexity
Differentiation/willingness-to-pay	◆Limited effectiveness of bundling nonoverlapping products (as opposed to complements) ◆Heterogeneity in customer preferences ◆Adjustment costs (customer, employee attrition)

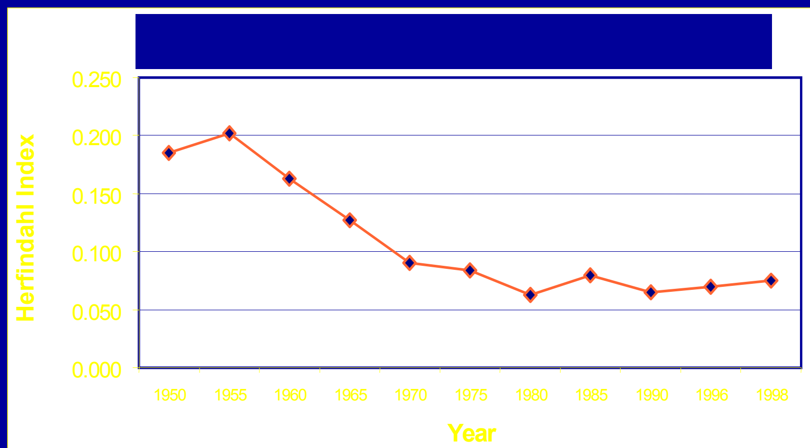
Limits To Value Addition through Merger

Levers Of Value Addition	Limitations
Enhancing Industry Attractiveness	◆Free-rider problems ◆Regulatory/non-market restraints
Forestalling Risks	◆Irreversibility of mergers ◆Unusual characteristics of cement market (product markets primarily regional/national, key competitors global--and relatively concentrated)
Generating Knowledge/ Innovation	◆Specific knowledge ◆Complexity/reuse costs ◆Internalization/coordination may reduce variety below requisite levels

Number of Competitors in Automobiles



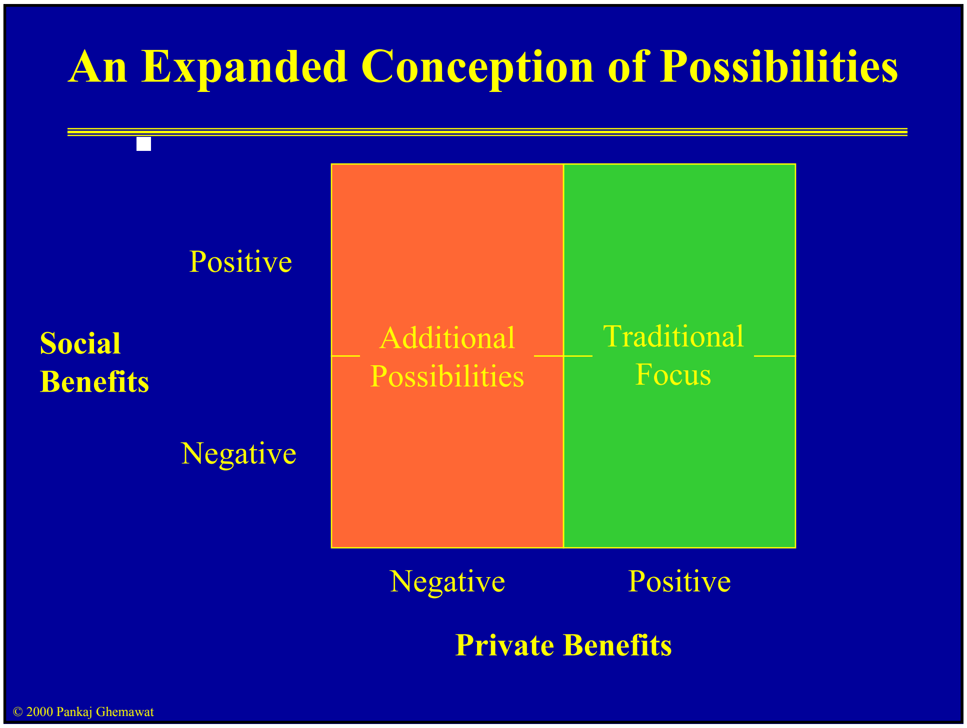
Global Market Concentration in Automobiles



Source: Ghemawat and Ghadar (2000)

Recommendations

- Recognition of enormous variation in outcomes
- Deeper understanding of industry dynamics and competitive strategy as opposed to a transactional approach
- Broader analysis of benefits and costs
- Recognition that practice can be improved greatly


An Expanded Conception of Possibilities
Positive
Social Benefits
Negative
Additional Possibilities
Traditional Focus
Negative
Positive
Private Benefits
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FTC Bureau of Economics Roundtable

Understanding Mergers: Strategy & Planning, Implementation, and Outcomes

McKinsey presentation
December 9, 2002

McKinsey&Company

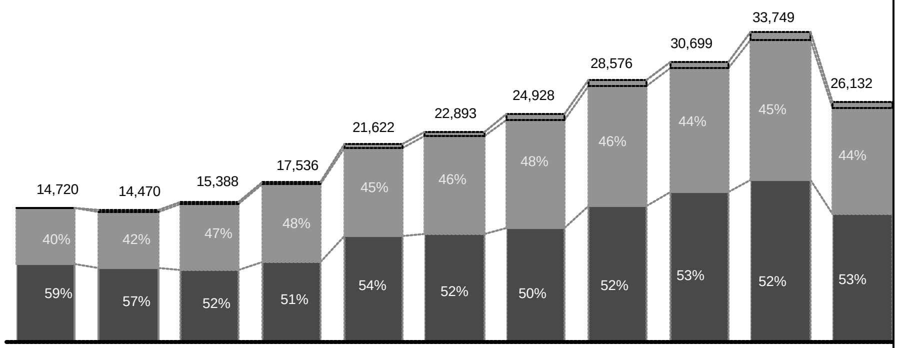
Agenda

- Recent research on the effectiveness of mergers
- Defining the value of success in mergers
- Examples of successful mergers

McKinsey&Company

M&A remains a key strategic option with deal volumes still at 1997-98 levels

Breakdown by size of total worldwide number of deals announced 1991–2001
US$ Billion

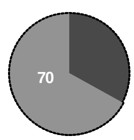
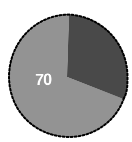
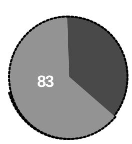


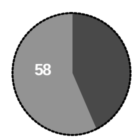
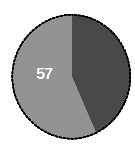
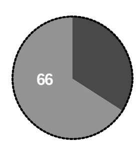
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total deal value* US$ B	342	354	449	558	936	1,096	1,607	2,477	3,263	3,383	1,681

* Includes only deals with disclosed value
Source: Thompson Financial Securities Data

McKinsey&Company

Research shows that in most cases mergers fail to deliver against their expectations, whatever the rationale

Study	Per cent failed*
McKinsey (2000)	
KPMG (2001)	
KPMG (1999)	

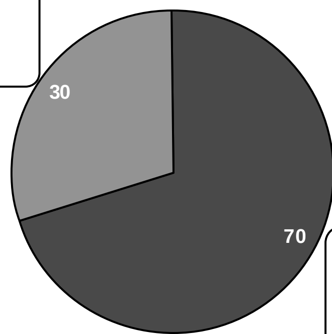
Study	Per cent failed*
AT Kearney (1998)	
Mercer (1996)	
Coopers & Lybrand (1996)	

* Definitions of failure range from no net growth to inferior stock performance relative to industry
Source: The Art of M&A Integration; industry literature

McKinsey&Company

Why are there so few winners?

Poor deal
- Unrealistic synergies
- Price too high
- Competitor reactions



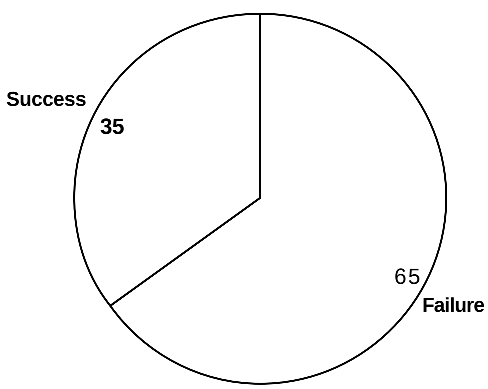
Good deal poorly implemented
- Poor integration management
- Failure to address cultural differences
- Customer losses
- Poor communication
- Poor tracking

Source: Interviews; McKinsey Corporate Finance Practice

McKINSEY & COMPANY 2000

Percentage of deals that fail to meet success criteria*

100% = 47 companies involved in a major deals between 1997-99



Key findings

The study found that failures were due to significant dilution of performance ethic, poor implementation, loss of key people. **Characteristics of successful mergers are strength of performance ethic, quick implementation, retention of key people, targets achieved, positive market indicators.**

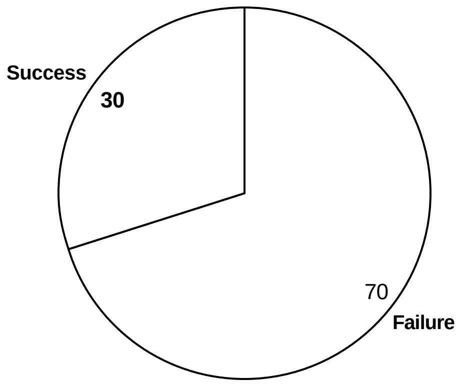
* Criteria for success: change in performance ethic profile and improvement in a combination of market indicators (share price, analyst opinion, revenue growth)

Source: Improving Merger Success by addressing Organizational Issues – Bekier, Dollenberg, Fox and Heede

KPMG 2001

Percentage of deals that failed to increase shareholder value*

100% = 118 companies involved in a major deal between 1997-99



Key findings

The study found that **successful deals used a robust and well-managed process**, priorities were allocated to the activities to be carried out, clear decisions were made about how and by whom the activities should be handled.

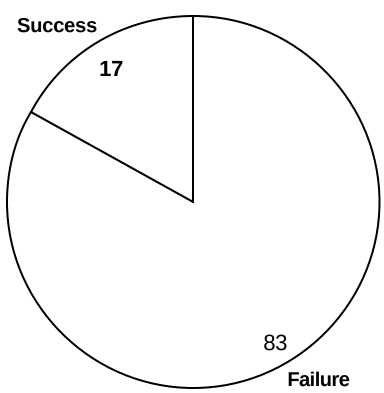
* Measured against a change in equity price pre-deal and again approximately 1 year after

Source: KPMG World Class Transactions– Insights into Creating Shareholder Value

KPMG 1999

Percentage of deals that failed to increase shareholder value*

100% = 107 companies involved in a major deal between 1996-98



Key findings

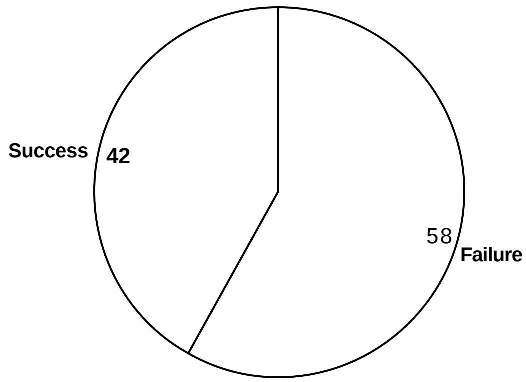
The study found that **successful deals engaged in a combination of the following key best practices**: synergy evaluation, integration project planning, due diligence, selecting the management team, resolving cultural issues, communications. Further, the study found that **chance of success increased for companies which undertook a combination of these practices early in the deal.**

* Measured against a change in equity price pre-deal and again approximately 1 year after

Source: KPMG Unlocking Shareholder Value

AT Kearney 2000

Percentage of companies showing an increase in shareholder value and profitability over a 3-year period post merger



Key findings

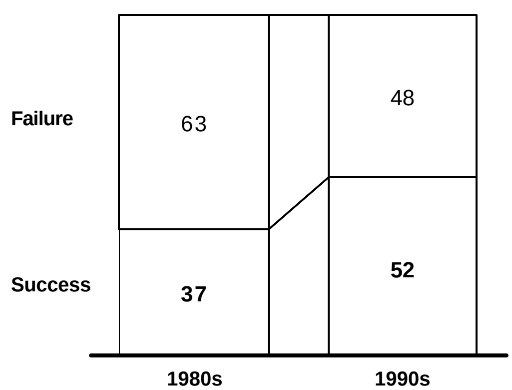
The study found that **58% of all mergers fail to reach the goals they set out to achieve – to increase stock prices and profitability.** Issues include failure to put corporate vision first, failure to move quickly enough in establishing leadership team, overemphasis on cost cutting vs. growth, failure to overcome corporate cultural differences, failure to communicate, and failure to manage risk.

Source: ***Seven Sins Can Snag Company Marriages***, Bangkok Post, 5/12/2000

Mercer Management Consulting 1997-98

Percentage of deals that achieve above-industry shareholder returns over a 3-year period

100% = 215 transactions valued at $500 million or more



Key findings

The mergers of the 1990s are substantially outperforming those of the 1980s. The improvement is not related to strategy or price but rather to **improved post merger management.**

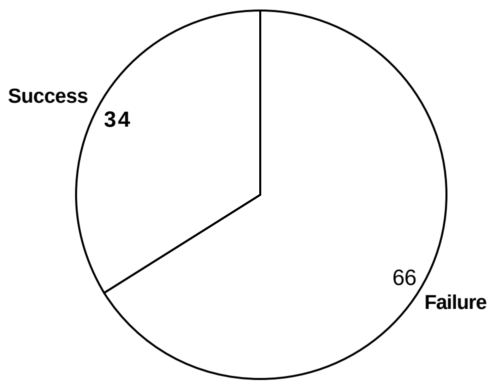
1) A compelling, ambitious vision, understood and shared by shareholders and management alike
2) A pragmatic approach to the alignment of all the pieces with the vision – organization structures, processes, systems and culture
3) A plan for a fast and focused transition.

Source: The Art of M&A Integration; Making mergers work for profitable growth, Mercer Management Consulting

Coopers & Lybrand 1996

Percentage of deals that are financially unsuccessful

100% = 124 transactions from 1993-1996



Key findings

The study found that 66% were financially unsuccessful.

By a substantial margin, surveyed companies reported that a rapid transition ("more quickly than their normal pace of work") had a more favorable effect on gross margin, profitability cash flow, productivity, and speed to market.

Quick transition companies also reported less difficulty with operating philosophy, management practices and information systems compatibility issues.

By almost nine to one, companies believed they should have moved the transition more quickly.

Source: The Art of M&A Integration, Speed makes the Difference:, Coopers and Lybrand 1997

True success is determined by the acquirers ability to achieve their strategic intent

	Sources of value				
Strategic rationale	**Cost synergies**	**Revenue synergies**	**Management improvement**	**Operational improvement**	**Examples**
Economies of scale	X		X	X	RBS/Natwest
Economies of scope		X	X	X	Vodafone/Mannesmann
Vertical integration	X			X	Time Warner/AOL
Diversification		X			Viacom
Market power	X	X	X	X	Daimler/Chrysler
Access to R&D	X	X			Cisco, Orange

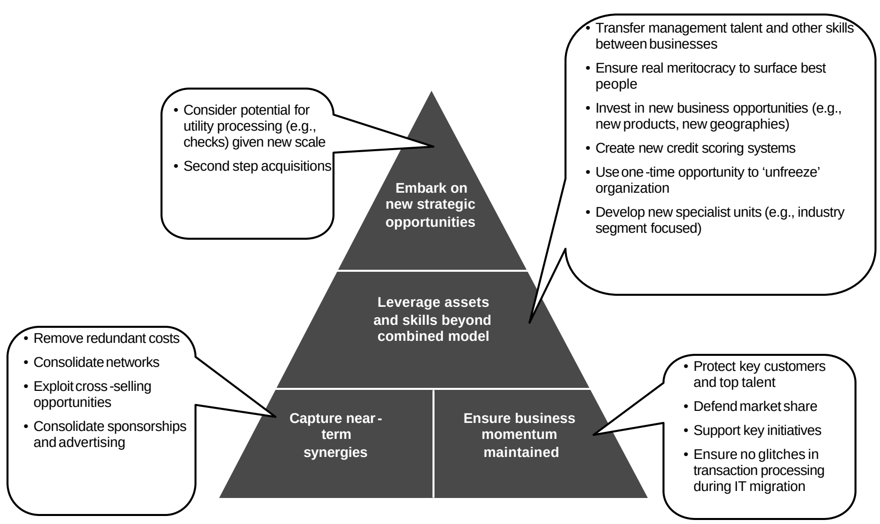
Determining if consumers benefit in mergers

Strategic rationale	Sources of value: Cost synergies	Revenue synergies	Management improvement	Operational improvement
Economies of scale	X		X	X
Economies of scope		X	X	X
Vertical integration	X			X
Diversification		X		
Market power	X	X	X	X
Access to R&D	X	X		

Value can benefit 3 parties

- **Increase shareholder worth**
- **Re-invest in company**
- **Benefit customers**
  - **Price reductions**
  - **Efficiencies**
  - **New opportunities**

The key value drivers must be understood



In summary, merger success is assured by focusing on value creation and on people issues rather than integration

1. Set high top-down merger goals that include both financial and non-financial aspirations
2. Recognize current business momentum has greater value than integration synergies and act swiftly to protect it
3. Ensure rigorous synergy identification through stretching top down financial targets and requiring bottom up confirmation
4. Capitalize on the unique unfreezing opportunity to achieve a superior new company
5. Move swiftly, front end load decision making and pursue 70% solutions that are 100% implementable
6. Conduct explicit handover from integration activities to business as usual with emphasis on building commitment to capture synergies
7. Appoint new managers as early as possible striving for excellence, even at the expense of perceived equity between merger partners
8. Identify the cultural challenges up front, based on differences between the two organizations and explicitly design a process to address them
9. Populate integration effort with top performers and managers with line experience
10. Communicate often and early, focusing equally on the process of integration and the content of key decisions made

Success stories

The merger	The deal	KSFs
BP – Amoco (also ARCO and Burmah Castrol 1998-2000)	This series of multibillion dollar transactions between 1998-2000 created a single, global company with a market cap of $200 billion. Chief executive Sir John Browne explained the vision behind the acquisitions, "In different ways, each of the steps we took helped us to fill a strategic gap that we had identified in the mid-1990s. These steps took us into natural gas and into the Far East, where we were traditionally weak, and into some of the best retail markets in the world. Our goal is to be a global player–we want giant fields that we can develop at low cost."	BP moved quickly to capture near term synergies and create common values and processes. They were able to cut costs by 20 percent of the combined BP-Amoco cost base. Within 100 days of closing the Amoco deal, BP had filled all the top management jobs and completed most of the cuts –including some 10,000 layoffs. During that period, BP-Amoco's stock price rose by nearly 11%. Browne also consistently and visibly led the change, facilitating open communications to all stakeholders and acting as a cheerleader for the merger. He imposed BP's structure and management style on the new company, an approach that ultimately resulted in the resignation of some senior figures at Amoco. However, the ultimate result was BP achieved the projected $2 billion in cost savings within the first year, a full 12 months ahead of schedule. BP, which reported a 19% increase in second quarter 1999 pre-exceptional profits to $1.36bn, presents a definitive counterpoint to the enduring notion that M&A activity destroys shareholder value.

Source: Lit search ("The Leadership Testing Ground", Journal of Business Strategy, Mar. 2002; "BP-Amoco's Result a Tribute to M&A Success", The Financial News, Aug. 1999)

Success stories

The merger	The deal	KSFs
Unilever – Bestfoods (2000)	This $24 billion cross-border deal aimed to create the preeminent global food and consumer goods company. The complementary nature of their geographic coverage and combined product portfolio together with Bestfoods' strong foodservice operations, enables the combined company to further raise their growth ambition.	The Unilever – BF team: • Moved quickly in the design and staffing of the organization – Announced October 2 the same day shareholder approval granted – "All Star Team approach using clear selection criteria • Aggressively acted on regulatory issues – Strategy to speed approval through divestments • Focused on top line growth – Leveraging Unilever brand in Latin America on BestFoods strength – Leveraging BestFoods brands in Asia on Unilever's strength – Cross channeling Unilever's Foods products through BestFoods channels – Focus on Go-To-Market operations in integration